

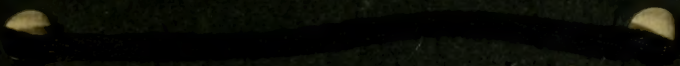


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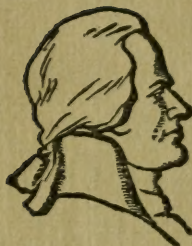


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[Modern business talks]

# THE BENEFITS OF SPECULATION

Price changes cause a serious burden for producers and consumers. This burden speculators take from their shoulders.



MODERN BUSINESS

TALK No. 40

(WITH VOLUME 20)

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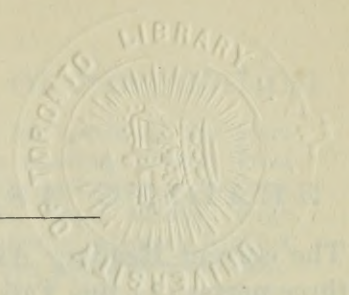
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# The Benefits of Speculation



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This Talk, to be read in connection  
with Volume 20, forms part of  
READING ASSIGNMENT 40

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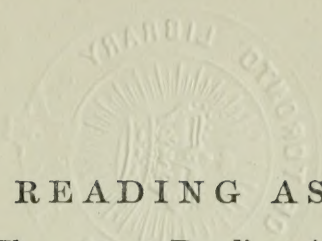
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## READING ASSIGNMENT

The current Reading Assignment consists of three parts: (1) this Talk; (2) Chapter XIII to the end of Volume 20, "The Exchanges and Speculation", and (3) Problem No. 20.

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Speculation is the trade of a few, but it affects profoundly the course of business. It is therefore a subject of the widest interest. The reader may have no expectation of playing the game, but he is interested in knowing the rules, in order that he may understand the operations of other men. An attentive reading of the present assignment will bring into clear relief the services of speculation as well as some of the abuses which frequently accompany it.



# The Benefits of Speculation

Economic evolution has produced the grain exchange, and benefits resulting directly from the establishment of this institution are uniform grades, honest weights, ample storage, large drying and cleaning capacity, adequate banking facilities and uniform and equitable trade rules. —Page 204, Chapter XIV, Volume 20 of the MODERN BUSINESS Text.

The train was speeding thru the great wheat country of North Dakota. It was harvest time and thru train windows farmers in their broad-brimmed hats could be seen busily engaged in gathering the golden grain. Had you watched them, as the train sped along mile after mile thru those vast fields of the world's staple, you might have marveled at the great wealth that mother earth was bringing forth and might have glowed with pleasure in thinking that perhaps this very grain would avert famine in sorely stricken Belgium or Armenia or Poland.

This may have been the very thought of two men in opposite seats as their eyes momentarily took in the busy harvesting scenes that suddenly appeared and just as suddenly disappeared as the train sped on. One of them was a bookish-looking man—he might have been a college professor—the other was evidently a business man.

“What a pity”, remarked the former, turning to

his neighbor, "that the same grain that furnishes food for nations also furnishes material for unscrupulous operations on the Chicago Board of Trade. In an ideal state of society such a thing could not exist."

"Did you say unscrupulous operations?" responded the other man. "Pardon me, but I am not sure I understand what you mean. Don't you regard speculation in grain as permissible?"

"Certainly not, and worse still, it is an economic waste. It lowers the price which the farmer receives for his wheat, and increases the price which the consumer pays. The operators get the difference."

"The shoe is on the other foot. The facts are exactly the opposite. Speculation in grain gives the farmer a fair price for his entire crop, and it puts the flour into the hands of the baker and the consumer at a lower price than they would have to pay if there were no speculative grain markets."

The first speaker was evidently taken back by the positive tone of his neighbor, but as prejudice dies hard, he managed to say with a tinge of sarcasm:

"Would you mind telling me who it is that looks after the farmer's interests? I didn't know he had any friends among the grain speculators!"

"With pleasure", came the quick rejoinder, "the bulls look after the farmer."

"The bulls?"

"Yes, the bulls. Mind, I do not say they are friends of the farmer, or that they care a rap about him, but in looking out for their own interests they promote the interests of the farmer. They are in busi-



ness to boost prices and they take advantage of every opportunity to do so. Hence in working for themselves they work for the farmer. In the same way the bears look out for the consumer, for they strive just as earnestly to pull prices down. Every unfavorable condition at home and abroad is utilized by them.

“Perhaps you recall the historic wheat firm of Joseph, Pharaoh & Company. You remember that Joseph was a very shrewd individual, but he lacked capital to carry out his plans until he induced Pharaoh to enter the firm. The Egyptian wheat market was overloaded with wheat and prices were low. The firm, thru its large purchases, started a bull market. The record is, of course, somewhat incomplete, but there is every reason to suppose that prices rose and that the Egyptian farmer was grateful. But for this speculative buying, wheat would have been a drug on the market. But there is no profit in buying unless you sell, and a few years later the firm became bears, and sold out their holdings. They did it judiciously, but again there is every reason to suppose that this selling movement lowered the price perhaps considerably below what it would otherwise have been. As the story is told, famine was averted in Egypt and it is generally conceded that the whole operation was for the benefit of the community.

“And don't you see that this interplay of speculative forces affecting demand and supply absorbs the greater part of the difference in price that would be caused by the element of risk if there was no inter-

vening medium of speculation—no ‘bumper’ to take up the shock? You undoubtedly realize that there is a big risk. Many things may happen to the price of wheat from the time it is growing in the field until it is turned into flour at the mill, and this risk would have to be assumed by either the farmer or the miller if there were no speculators to shoulder the burden.”

“Then in your opinion grain speculation is only the operation of economic law? I haven’t thought of it in that light.”

“Probably you know more about economic laws than I do, and I shouldn’t put it that way, but I am certain that grain speculation is a necessity from the standpoint of business.”

“Well, perhaps you are right; still——” But now he had reached his station and left the train, evidently still thinking about what he had heard.

### SELLING WHAT YOU HAVEN’T GOT

The usual form which speculation in grain assumes is that of trading in “futures.” Much invective has been hurled against the practice and legislatures in various countries have at times tried to stop it. In Germany the “Exchange Act” of 1896 specifically forbade all exchange for future delivery. So far from eliminating the evils of price fluctuation, it exaggerated them. After a short trial the law was repealed. There are many in the United States who have not learned by this example and who are constantly pressing Congress for legislation against

futures. They have not been successful, tho they have from time to time brought state legislatures to their views, only to disturb the normal current of business and pave the way for repealing legislation which has rarely been long delayed.

### OFFICIAL INDORSEMENT

We are living in an era of investigation. The suspicion that "there is something rotten in Denmark" is widely prevalent, and when this suspicion fastens on anything the first impulse is to refer the matter to a congressional committee or to some special commission appointed by the national or state government. Legislators have shown themselves very prompt to obey that impulse.

The exchanges dealing in commodities as well as those which handle securities have been a shining mark for the investigator. Reams of paper have been filled with the printed testimony and every detective stunt known in fact and fiction has been employed to "get something on" the exchanges. With seeming reluctance, yet with practical unanimity, all these commissions have come to the conclusion that the exchanges with their operations of dealing in futures and short selling are legitimate and necessary in the present stage of business development. Vicious practices have been found, untold abuse of speculative facilities has been uncovered, but the weaknesses and follies of the individuals who operate on the exchanges do not condemn the institution.

Some of the benefits of speculation in our present



business organization are tersely stated by the United States Industrial Commission as follows:

First, to localize the risks of distribution among a special class of experts presumably well informed as to the facts of supply, demand, credit, exchange and the cost of distribution.

Second, to relieve producers and consumers alike of the expense and risk of being responsible for a year's production, thus freeing the cash income of both of these economic interests for other uses than those of protecting and providing a long-term supply of utilities.

Third, to reduce the profits of trade by ready and active competition among the various speculative interests toward a minimum of cash per unit of the commodity handled, by conducting distributive operations on a large scale.

### THE OPEN MARKET

Speculation, for good or ill to those who engage in it, but undoubtedly to the advantage of the community at large, finds a place wherever the market is free and open. The exchanges are simply an expression of a world-wide demand for certain securities and commodities. Among the latter, wheat occupies the foremost place, and the author therefore introduces us to the Chicago Board of Trade, the world's greatest wheat market. Its methods are explained in detail and any mystery in which they are enshrouded in the mind of the average man is dispelled.

The detailed discussion of the wheat trade dispenses with an equally full treatment of dealings in allied products—corn, oats and provisions. But to the cotton trade with its important exchanges in New York and New Orleans a special chapter is given.

Together with the securities markets described in

the earlier part of his text, these are the fields in which speculation has found its chief abiding place.

### INVESTMENT, SPECULATION AND GAMBLING

It is not to be denied that there are people to whom investment seems to be long-term speculation and speculation little more than long-term gambling. They argue that gambling is bad for the individual and hence it is a menace to society. To those so minded it is only a step to bring all speculation under condemnation. In the modern world investment bears the mark of respectability, but it is a familiar fact that some old moralists used to look equally askance at investment.

It would take the brains of a Philadelphia lawyer to make a definition of these three terms which would satisfy everybody. This does not deter the author from treating the subject. He makes his point by describing speculation and showing when it degenerates into gambling, but he judiciously avoids trying to compress the whole subject into a single sentence. While the three activities are in some of their phases quite distinct, it must be conceded that they shade off into one another, and no one can draw the line which would classify those who use the exchanges as the sheep and the goats. Neither they nor their operations are of one type, but of many. They run the gamut from the conservative investor to the seedy hanger-on, who picks up a tip on the market or plays a hunch.

The investor looks mainly to the interest on his

capital, but he may find it necessary to protect this capital and is not averse to augmenting it. He thus becomes seller as well as buyer, and if he changes investments frequently enough, becomes a speculator. In general he is interested mainly in the long turns in the market from which he seeks to draw a profit. His moves are based on information.

The speculator is more actively on the market, and he too acts on information more or less complete. And so unconsciously he embodies the elements of demand and supply, and helps economic law to the fullest possible play. He watches not only the long but the short turns in the market and seeks a profit in these lesser changes which occur from day to day. If he uses poor judgment of the facts, if he bases his moves upon inadequate knowledge, and especially if he acts upon facts which are not pertinent he is not far removed from the gambler who takes a long chance.

The gambler simply woos the goddess Chance. He deludes himself into thinking he has grounds for his action, but they are not rational. When the turn of fortune favors him, he boasts his insight; when it goes against him, he curses his luck.

### FALSE PRETENSES

A woman who had heard her other half praised as a model husband was much impressed and thought she would like to know the precise meaning of the phrase. Consulting her dictionary she read "MODEL, a small imitation of the real thing." This



definition might well be applied to the bucket shop in relation to a regular broker's office. But if you read the author's excellent account of these plague spots, you will be convinced that not only are they imitations, but counterfeits.

The suckers for whom these establishments are baited may think they are in the market, but they are not. They do nothing, they merely bet on what others are doing. Of course their stakes are not heavy, but they exert no influence on the market. Sales and purchases in the bucket shops are purely fictitious. They never reach the exchanges or add one whit to the demand or to the supply.

The law suppresses these excrescences on legitimate business, and it is well that it should be so. No law can wholly protect a fool from his folly, but it is to be commended if it shields in some degree the wives and children of the fool.

### STACKING THE CARDS

Men of business use the exchanges for legitimate business purposes. As already noted, the exchanges focus the forces of demand and supply at one place and relieve industry by creating a body of specialists in risk-taking ready to assume the risk of price changes. It would be foolish to deny that men of gambling instincts find an excellent field for operation in buying and selling on the exchanges. They may be blind buyers and sellers, but their activity is one of the things that make the fine balancing of demand and supply which the exchanges bring about.

The wisdom of the ages has taught us not to burn the wheat in order to destroy the chaff.

If we have a sneaking sympathy for those who sit in at a card game, there is nothing but contempt and often violence for those who stack the cards. We may be indulgent to stock exchange gamblers, but public opinion and the exchanges themselves are rigorous on all who play the game unfairly.

### LEGITIMATE SPECULATION

Speculation which is open and above board is a real benefit to the community. Its function is thus described by a successful operator in securities of wide experience.

“Of course in stock speculation as in all other forms of speculation there are many risks. Without risks there would be no speculation. But will you tell me, if you can, of any business in which there is no risk? Is not every credit transaction attended by risk, and is it not by that very fact an act of speculation? If you are a merchant selling goods on credit, you are compelled to take certain risks as to the eventual payment of the bill, and since most merchandise sales are made on a credit basis, speculation runs thru our entire system of doing business. And speculation in stock is no more beneficial or harmful than speculation in groceries or hardware or textiles.

“Do you know”, he continued, “why so many losses have to be borne by wholesalers and manufacturers thru the failure of retail merchants? Outside of so-called ‘acts of Providence’, there are just three

causes: insufficient information about their debtors' business; false information, and inadequate use of the information available.

"It is precisely the same in the case of those who lose in their speculations in securities. Many of them trade upon insufficient information. They do not investigate the history of the security. They do not trace its movement over any considerable period nor do they investigate with due care, if at all, the character of the management, the prospective market for the company's product and the many other factors that enter into the equation to determine the probable success of the enterprise."

"Do you mean to say", he was asked, "that those who buy securities do not carefully investigate the companies or properties back of them?"

"Yes. As a matter of fact, many who consider themselves conservative speculators act upon information which they do not and perhaps cannot verify. They buy upon a tip from one who they think knows, and they sell upon the strength of a rumor, the source of which they cannot trace. They are often nervous, ready to jump at a moment's notice, eager to buy at the first sign of an advance and equally ready to sell when a small cloud appears in the horizon. These are the speculators for whose sake chiefly the market is manipulated. Their losses are generally traceable to the fact that they are misled by false information."

"Is there any general cause of such losses?"

"Probably the largest losses, both as to number and amount, are caused by the inability of some



speculators to read aright the signs of changing conditions. They are the 'stickers.' Having bought a stock, they hold on to it, closing their eyes to the prevailing market indications. In a rising market they hold out for a higher rise, and when the inevitable decline sets in, they are still holding out in the belief that the price will soon rise again.

"Now", the speaker concluded, "just as the successful merchant is he who takes pains to acquire all obtainable information about his customers and who knows how to make this information bear upon the question of their credit, so the successful speculator is one who follows exactly the same plan in determining the safety of the securities he thinks of buying and the timeliness of buying or selling."

### THE INDIVIDUAL AND SOCIETY

There is an old saying that a fool and his money are soon parted, and Wall Street is the daily witness to its truth. But Wall Street wastes no sympathy on the fool, and neither does the world at large. Yet he has his friends and they have been eloquent in their pleas on his behalf. They make him appear the victim of a vicious system, and condemn speculation in unmeasured terms.

They make a good story, but you will notice that they speak always in terms of the individual, not of society. They would have you believe that because men go down to ruin in stock speculation, stock speculation is morally wrong. Business has little patience with them and goes its way undisturbed.

The question whether speculation is beneficial or otherwise is not to be judged by its effects on Smith or Jones. A buzz saw is not less useful to the world because it brings trouble to the man who monkeys with it. The fact that a man engages in a business he does not understand and comes to grief does not make the business either cruel or immoral. The fact that a man yields to the temptation of the market, speculates and loses the trust funds committed to his charge does not make the market a thief.

Business and sound common sense look upon speculation from a broader point of view. They ask, does it bring hardship or benefits to the community as a whole? And they find the weight of evidence to be that it is beneficial.

### SHOULD I SPECULATE?

Many a time a business man is asked "Do you advise me to speculate?" and refuses to give an answer. That is not a question for others to decide. Each man in his heart knows his own strength and his own weaknesses, and each man knows better than any one else whether he can afford to take risks. Really that narrows itself down to the question, can he support the loss which the risk may entail? And if the answer to that question involves the welfare of others for whom he is responsible or to whom he is accountable, then, and then only, it is a question of morals.

If his action jeopardizes no one but himself, it is merely a question of judgment.

## THE EQUIPMENT OF THE SPECULATOR

There is much virtue in the homely injunction not to plunge into deep water unless you know how to swim. If you are tempted to plunge into the sea of speculation it would be well to bear this in mind. You cannot swim or float in its troubled waters unless you are buoyed up by a sound knowledge of its currents. Their intricacy and uncertainty are well displayed in the concluding chapter of the present reading assignment. Whether it leads you to a conclusion as to what to do or what not to do, you will find this whole volume intensely interesting, and your knowledge of fundamental business principles broadened thru reading it.



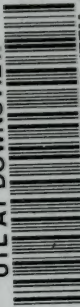








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